No. 8122.

In the United States Circuit Court of Appeals

For the Ninth Circuit.

16

Commissioner of Internal Revenue, *Petitioner,* vs. Berkeley Hall School, Inc., *Respondent.*	}

On Petition for Review of Decision of the United States Board of Tax Appeals.

BRIEF FOR THE RESPONDENT.

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BRIEF FOR THE RESPONDENT.

OPINION BELOW.

The only previous opinion in this case is the opinion of the Board of Tax Appeals [R. 14-32], which was reported in 31 B. T. A. 1116.

Jurisdiction.

This petition for review involves income tax for the fiscal year ending June 30, 1925, in the amount of $12,-021.99 [R. 15], and is taken from a decision of the Board of Tax Appeals entered January 31, 1935. [R. 32.] The case is brought to this Court on a petition for review filed April 13, 1935 [R. 33-40], pursuant to the provisions of sections 1001-1003 of the Revenue Act of 1926, c. 27, 44 Stat. 9, 109-110, as amended by section 1101 of the Revenue Act of 1932, c. 209, 47 Stat. 169, 286.

Question Presented.

Whether property received by respondent, who operated a Christian Science School, through the efforts of parents of children in the school, which property was definitely impressed with a charitable trust for the establishment and maintenance in perpetuity of a school for children under the influence of the Christian Science faith, is subject to income tax in the hands of respondent.

Statement of Facts.

We summarize the facts found in favor of the respondent by the Board of Tax Appeals.

In the year 1911 the Misses Leila and Mabel Cooper and Miss Mary E. Stevens, organizers of respondent and its sole stockholders, opened a Christian Science School in the city of Los Angeles. Respondent, however, was not incorporated until the year 1920 as a private, educational institution. By reason of prohibitions of the Christian Science Church it could not be chartered as a church school. Instruction in the school has at all times been limited to children of Christian Scientists, entrance requirements being that the parents are students of Christian Science and that pupils attend Christian Science Sunday School and be recommended by two practitioners. [R. 82.]

The school progressed but the organizers drew no salaries and the small profit realized was employed in the acquisition of additional facilities. In the year 1923 respondent's assets had a value of $25,000.00 against which it owed $13,000.00. [R. 67.]

For some time prior to the year 1923 parents of pupils in the school realized the lack of recreational facilities for the children and the necessity of securing more extensive

school quarters, or the abandonment of the school. The parents held many meetings, the first meeting being held in the year 1919 [R. 43], they were desirous of continuing the school that their children might continue under the influence of the Christian Science faith. Some of the mass meetings held were attended by as many as fifty or sixty parents of children in the school. An informal organization of the parents was effected known as the Berkeley Hall School Project. Mr. Swarzwald, a witness [R. 69] presided at the meetings. Committees were appointed to look into the feasibility of selecting and financing a site for a new school in the Beverly Hills District of Los Angeles. Respondent played little or no part in the projected plan. Respondent had nothing to do with the selection of the site for the school.

From time to time certain plans were discussed and found not feasible and nothing of a final nature was accomplished until April 13, 1923, at which time a group of the parents with financial worth of easily $2,000,000.00 [R. 51] jointly and severally agreed to guarantee the payment of $250,000.00 toward the purchase of fifty or more acres of land in the Beverly Hills District "as outlined at a meeting held this day at Berkeley Hall School". [R. 100.] The group of parents had conceived the plan of acquiring the acreage, subdividing same and so pricing the lots as to realize an overplus from the sale thereof after meeting the purchase price, to be used for the construction of new school buildings on the unsold acreage.

The parents selected Mr. Gilchrist, one of them, as their fiscal agent and representative to carry on the transaction to consummation. Mr. Gilchrist learned that a tract of land consisting of approximately 77.3 acres could be ad-

vantageously purchased in Beverly Hills. At a meeting of the parents it was unanimously agreed to acquire said acreage. An option was secured obligating a total purchase price of $462,180.00, payable $75,000.00 upon the execution of the conveyance and the balance at stated intervals. On April 30, 1923 [R. 101] some of the parents advanced $10,000.00 as an earnest money payment on the option, which sum would have been forfeited on failure to exercise the option within eight days by the payment of $75,000.00. On May 1, 1923 [R. 98] certain of the parents entered into a guarantee in favor of the Rodeo Land and Water Company, sellers of the tract of land, guaranteeing in a sum not to exceed $135,000.00 for the purchase of improvements on the tract and as payment on the acreage. Neither respondent nor any of its stockholders or officers were among the guarantors on either of the instruments referred to.

The acquired tract of land, with the exception of seven acres which were set aside for the new school buildings, was subdivided by Mr. Gilchrist into lots, prices fixed on each lot, and the project placed upon the market for sale. This was on the 30th day of April, 1923. The parents, in the order in which their names appeared on the guarantee, were given the right to purchase the lots at the release prices. Practically all the lots were sold within a period of eight days, many to parents of children of the school. Others were sold to friends and some few to the public. The parents realized a profit on the lots purchased by them. However, Mr. Swarzwald testified: "Some however, I still have and I would be very glad to sell it for half of what I paid for it". [R. 59.]

The parents had no legal organization. All formal steps in relation to the acquisition of the property were taken in the name of respondent, some without its knowledge. At the inception of the acquisition of the acreage the parents were required to secure the sum of $100,-000.00. They called upon Mr. Orra Monette and Mr. J. E. Randall [R. 89], of the Bank of America, which institution was desirous of helping the religious and semi-charitable proposition. When being shown the guarantee of the parents the bank consented to make the loan. Before, however, it became necessary to provide the money through the bank loan there had been sold a sufficient number of the subdivided lots to meet this initial payment and the loan was thereby made unnecessary. In subdividing and passing titles to the property the parents selected the Bank of America to act as Trustee for the purpose of taking title to the land, executing the conveyances of the several lots, collecting the proceeds of sale, paying the development costs, and the installment payments to the Rodeo Land and Water Company. [R. 103.]

Under the setup in April, 1923, it was contemplated that the Bank would be required to advance approximately $135,000.00 to cover initial payments on the purchase price which would be repaid from the proceeds of lot sales. The rapidity of the marketing of the lots was beyond the expectation of all and before the title search was completed all but two or three of the lots had been sold.

The Declaration of Trust [R. 103], wherein the Bank is designated as Trustee, the Rodeo Land and Water Company as the seller of the property, and Berkeley Hall School as beneficiary, was brought about through a committee of parents or their representative, Mr. Gilchrist.

Respondent in this regard acted merely as directed by the parents or Mr. Gilchrist. Not any of the stockholders or officers of respondent possessed business experience. Leila Cooper, president of respondent, testified that she signed as director to make possible the execution of the plan conceived by the parents for the establishment of a school for children under the influence of the Christian Science faith.

In view of the religious and educational character of respondent, the Bank of American handled the matter of the escrow and Declaration of Trust for practically one-third of its regular fee.

In subdividing property a Declaration of Trust somewhat similar to that employed in the instant case was generally used. Here, however, the services to be rendered by the Bank Trustee were greatly limited, since at the time of the passing of title to the Trustee and the execution of the Declaration of Trust nearly all of the lots in the tract had been sold and cash had been received in excess of $100,000.00 to meet the initial payments to the Rodeo Land and Water Company, Trustor. To this extent the Trustee was not called upon to receipt or account for sales made.

It was at all times the intention of all those interested in the new school project that they should create a fund for the establishment and maintenance in perpetuity of a school to be operated under the influence of the Christian Science religion. Respondent had no cost in the project and did not enter into the transaction for profit. The

majority of the funds realized from the sale of the lots over and above the cost and development expenses were not paid to respondent but were paid out by the Bank, Trustee, direct to the contractors who erected the new school buildings. Any amounts paid to respondent were entered upon its books in a separate account from its own funds and were expended only under direction of a committee of the parents in furtherance of the building program.

The trust with the Bank of America was not terminated until 1927 at which time title to the undisposed acreage was transferred to respondent as beneficiary of the trust. Respondent, its officers or stockholders, did not at any time consider the new school project as their property or to do with as they saw fit but, on the contrary, all interested parties were of the impression that the property and all moneys received as result of the land transaction were impressed with a trust.

Respondent, upon receipt of the property and completion of the school buildings coming to it as beneficiary of the trust, made efforts to secure the perpetuation of the project and property as a foundation in accordance with the desire and intention of the parents' organization. Judge Douglas Edmonds, a prominent member of the Christian Science Church, made a trip to Boston, Massachusetts, to the headquarters of the Church, and asked for respondent and the parents' organization that the Church accept a transfer of the property from respondent and act as the permanent trustee in administration of the

fund. This request was refused by the Church for the reason that its activities were limited to those of religion and under its rules it could not assume as trustee the operation of the school. Steps were thereupon taken to effect the same result through a permanent trustee other than the Christian Science Church, wherein the Christian Science Church would become the beneficiary in the event of the dissolution of respondent; at the time of the trial, title to the school property stood in the name of the Title Guarantee and Trust Company, held by it in trust for the perpetuation of the school which trust is governed by a Board of Trustees, upon which Board stockholders of respondent have membership. [R. 87.]

The Board found the facts in favor of respondent, determining therefrom that a charitable trust had been created for the purpose of perpetuating a school for friends of Christian Science; that the parents had no intention in arranging for the acquisition of the property by the respondent, that the amounts voluntarily paid by them in excess of the cost of such lots should not inure in any way to the personal benefit of the respondent and its stockholders. It was the intention of the parents, as found by the Board, that the profits accruing from the land transaction should constitute a trust fund for the establishment and maintenance in perpetuity of a school for children at Beverly Hills, to be operated under the influence of the Christian Science religion.

SUMMARY OF ARGUMENT.

The Property and Benefits Were Received by a Tax-Exempt Institution Under Section 231 (6) of the Revenue Act of 1924.(*)

The record shows that respondent never declared a dividend; that the three women stockholders and operators thereof received nothing of value by reason of their interest. Although respondent was organized as a private corporation for profit, in substance, it never functioned as such. No part of its earnings inured to the benefit of any private individual. In tax matters, substance must give way to form.

Consideration must be given to the educational and religious features incident to respondent's purposes and also the objective of the large philanthropic group of parents and the donative character of their benefactions. If the contention of petitioner is sustained, it must result in granting to the three Christian Science ladies, stockholders of respondent, the right to have at any time sold the Beverly Hills acreage and school buildings or to have taken in the year 1924 the surplus monies realized from the sale of lots, all of which represented gifts from the parents, and appropriated all of the intended benefits for the school project to themselves for their personal aggrandizement. If petitioner's theories are to be main-

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(*) Sec. 231 (6). Corporations, and any community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

tained, a winding-up and liquidation of respondent corporation would result in personal gain to its stockholders of the parents' benefactions.

Respondent or its stockholders played no part in the acquisition of the property other than to acquiesce in the use of its name. The taxable year involved is 1925, yet the efforts of the parents to secure a new school site were first undertaken in the year 1919. The parents were not aware that respondent was a private corporation, or even that the school was a corporate entity; their thought was merely the creation of a new school, perpetually devoted to the furtherance of the religious principles of Christian Science, which faith was possessed not only by all the parents but also by the stockholders of respondent and by the banker, whose charges were reduced to one-third because of the charitable character of the project.

Notwithstanding the religious aspect of respondent, it was necessary that it be chartered as a private educational institution, since the Christian Science Church did not foster private scholastic education and therefore respondent was not permitted to designate in its charter a religious object, contrary to the mandates of the Church.

Respondent was designated as beneficiary of the trust created with the Bank of America as Trustee, to facilitate collections under the sales contracts, transferring titles and disposition of the funds. It was definitely understood by all interested parties, including the bank-trustee, that when respondent should receive the unsold acreage and the net proceeds from the lots sold, it would receive these benefits not for its own use and advantage but in a fiduciary capacity. The funds were at all times so regarded by respondent and were not set up on its corporate

books as its property, but were administered by a committee of the parents. Under these circumstances, coupled with the common understanding as to the dedicatory purpose of the project and the impression of a charitable trust upon the benefits received, under the California law, which is controlling here, injunctive relief would lie on behalf of the parents should respondent fail to live up to its covenants and the understanding of all concerned in relation to the perpetuation of the school enterprise. (*Simons v. Bedell,* 122 Cal. 341; *Cooney v. Glynn,* 157 Cal. 583; *Political Code* (1923), Art. 8, Secs. 470, 472.)

The record clearly exemplifies that all the essential elements of a charitable trust are present in this case. Charitable trusts are basically very similar to private trusts, the chief dissimilarities resulting through the encouragement and favor that the courts have bestowed upon charitable trusts in the long period of their existence.

> "It is said that courts look with favor upon charitable gifts, and take special care to enforce them, to guard them from assault, and protect them from abuse, And certainly charity in thought, speech, and deed challenges the admiration and affection of mankind. Christianity teaches it as its crowning grace and glory; and an inspired apostle exhausts his powerful eloquence in setting forth its beauty, and the nothingness of things without it." II Perry on Trusts, 687; Estate of McDole, 215 Cal. 334.

In the continued effort to encourage charitable acts, the courts have let down the bar on strict interpretation and have consistently relaxed the rules pertaining to private trusts, and have strived without cessation to give full effect to the intention of a benevolent donor. (*Russell v.*

Allen, 107 U. S. 163.) A charitable trust is one for the benefit of indefinite persons to be selected by the trustee from the public generally, or from some particular class or part of it, as was clearly pointed out in *Collier v. Lindley,* 203 Cal. 641. *In re Graham's Estate,* 63 Cal. App. 41.

In *Estate of McDole,* 215 Cal. 334, the court said:

> "It is of the essence of a charity that the beneficiaries are indefinite, the class only being indicated. It is frequently characteristic of charitable trusts that the manner in which the trust is to be carried out is not declared."

Respondent in its private corporate capacity was not the beneficiary; the funds in dispute were not received by this respondent for its separate use or disposition. If so received by it, it was a gift from the parents, which exempts it from income tax, but a sounder theory would be that respondent received same as a fiduciary.

The juristic charitable trust created by the parents, respondent and its three stockholders is a separate taxable entity, created, "organized and operated exclusively for religious * * * or educational purposes" within section 231 (6).

> "Evidently the exemption is made in recognition of the benefit which the public derives from corporate activities of the class named, and is intended to aid them when not conducted for private gain." *Trinidad v. Sagrade Orden de Predicadores,* 263 U. S. 578.

The Board held that the land was purchased and sold for the school. That the activities of the parents impressed the proceeds with a trust, which respondent accepted; that the school was exempt from taxation since it took the property without cost to it, with the understanding that such trusteed property was to be devoted to a definite charitable use, namely, the establishment and maintenance in perpetuity of a school for children under the influence of the Christian Science faith; and that the parents could, through process of court, enforce the trust or restrain respondent from diversion of the property to other uses. Respondent therefore cannot be taxed upon the funds in dispute unless received by it in a transaction entered into for profit for its separate use, benefit and advantage. (*Eisner v. Macomber,* 252 U. S. 189; *Corliss v. Bowers,* 281 U. S. 376.

Respondent as a fiduciary is not before the Court, since the sixty-day letter charges the respondent with the tax in its individual corporate capacity. Petitioner could with equal effect have sent his deficiency letter to the Bank of America, who, as a trustee of the acreage, first received the profits.

The rule is announced in *Shea v. Commissioner of Internal Revenue,* 31 B. T. A. 513, that the Revenue Act recognizes as a separate taxable entity a fiduciary of a trust and the same person acting in an individual capacity —"income and gains of the two are separately taxed"— and to impose the tax burden, the proper taxpayer must be brought before the Court.

The Property in Question Was Received by Respondent as a Gift.

Property received as a gift is not subject to taxation under the regulations (Art. 73, Reg. 69-Reg. 65). We find much judicial opinion holding that the value of property conveyed, even by business organizations, is not subject to tax, where the consideration moves from others than the donee or grantee.

The value of the property conveyed to a company by a group of business men to induce it to locate its business on the property is not taxed.

Appeal of Holton & Company, 10 B. T. A. 1317.

The donative nature of the transaction is most conclusively evidenced by the absence of an important part played by respondent, it or its officers having made no contribution to the initial down payment of $10,000.00 and the second payment on the purchase price of the land of $100,000.00, or even obligating themselves on the guarantees. The funds were all raised by the parents or through their syndicating agent, Mr. Gilchrist, or through the sale of lots all concluded without the necessity of employing the proffered loan from the bank.

This, however, does not change the nature of the transaction or understanding among all of the persons involved, namely, that the parents acquire the land, subdivide and market the lots to be sold, to realize a fund to be used in the erection of buildings on the unsold acreage, which was to be employed as a Christian Science School, all without financial responsibility on the part of respondent; since respondent possessed only an equity of $12,-000.00 in its school property it could play no part in the financing of a $462,180.00 liability.

Petitioner assumes that the delivery of the Declaration of Trust with the Bank, being Exhibit A1 [R. 103], was the generating source of the tax and relies upon section 704 (b) of the 1928 Revenue Act as authority to impose the deficiency. The facts are that the Declaration of Trust was dated the 1st day of June, 1923; in this, the respondent is designated as the beneficiary. The gift to respondent or its assumption of a fiduciary responsibility was completed long before June 1st, 1923. The sum of $10,000.00 as earnest money was paid April 30, 1923. [Petitioner's Exhibit 3, R. 101.] It was on April 13, 1923, when the parents executed their joint and several guarantee in the sum of $250,000.00. [Petitioner's Exhibit 2, R. 100.]

In furtherance of the obligations imposed under the Agreement to Purchase the Land, the parents did, before May 8th, 1923, have available for payment an additional sum of $100,000.00. We therefore find an executed donative transaction prior to the signing of the Declaration of Trust with the Bank. This is further evidenced by a provision of the said Declaration of Trust with the Bank [R. 104], viz:

> "Whereas, the said beneficiary on account of said purchase price has paid to the said trustor, the sum of One Hundred Thousand ($100,000.00) Dollars, collected upon proposed sales of property hereunder, receipt whereof is hereby acknowledged by the said trustor from the said beneficiary."

All parties interested in the enterprise realized the complete success in the marketing of the lots prior to June 1, 1923. The voluntary contributions of the organization of parents of the students attending respondent's school and

their labors in initiating the purchase of the property and effecting the sale of the lots under the parents' plan was fully consummated before the conditions imposed upon the Bank of America as Trustee under section 704 (b) of the 1928 Revenue Act and by its provisions became operative upon the Declaration of Trust. This section petitioner desires to apply retroactively to a charitable and true trust in attempting to gather a tax from respondent, while the section applies only to associations or syndicates. The parents were unincorporated; as an association they could not take title to property. Therefore, it was natural that as a matter of convenience in carrying out the plan of subdividing the property transactions be carried in the name of respondent.

A fundamental difference between the petitioner's and taxpayer's conception of the issue is that of origin; it is the difference between substance and form. Mere form must be brushed aside in order that the true nature, object and substance of the transaction may be ascertained. More than use of respondent's name in the transactions must be shown.

To allow the assessment to stand, would be to allow mere form to govern, whereas, the rule in taxation generally is that substance and not form controls.

Kennedy v. Commissioner, 16 B. T. A. 1372.

Also see, to like effect:

Southern Pacific Co. v. Lowe, 247 U. S. 330;
Gulf Oil Corporation v. Lewellyn, 248 U. S. 71.

An examination of the exhibits without giving consideration to the record might lead to the belief that re-

spondent was a principal in the transaction; however, it cannot be said that the forty or fifty parents, guarantors and contributors, played no part in the consummation of the plan. Nor can it be said that the substance of the whole undertaking was not to secure a new school site for the establishment of a school for their children, with definite objectives and without limitation as to time.

It cannot be seriously contended in the face of the harmonious and exhaustive record that respondent without the aid of its benefactors could have engineered this project and that the Bank without the parents' guarantee would have agreed to loan $100,000.00 as the initial payment to the Rodeo Land and Water Company for the purchase of the tract. The parents, donors, fully completed their agreement, and to this day each and every step in accordance with the solemn promises made by the many parties interested and the respondent have been fully complied with and the conditions surrounding and attached to the donations have been fully executed, resulting in a material public benefit.

Petitioner in his brief imposes upon respondent the burden of showing that the transaction is exempt from tax. A taxpayer claiming an exempt status must assume the burden of proof and show that it falls within the purview of the exemption—this we have done in the immediately preceding topical heading; but where a gift is involved, whether outright or with limitations, the preponderance of evidence rule controls in tax cases. The California Civil Code, sec. 1146 (1923) defines a gift as:

> "A transfer of personal property, made voluntarily, and without consideration."

In the instant case all elements of a gift are present; whether or not there are restrictions or limitations upon the gift is not important from a tax standpoint. A strong presumption exists in favor of respondent, as all the persons interested were Christian Scientists, devoutly interested in their faith and in the rearing of children in a Christian Science atmosphere, who set about to accomplish a definite purpose, not entered into for profit but presumptively in the cause of religion or like charitable purposes.

Conclusion.

It is respectfully submitted that the decision of the Board is supported by unconflicting and conclusive evidence, is fundamentally correct and should be affirmed.

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